

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Legend

X =

State =

Date1 =

Date2 =

Date3 =

Trust =

A =

Dear :

This letter responds to a letter dated October 7, 2009, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on Date1 and elected to be treated as an S corporation effective Date2. On Date3, shares of X stock were transferred to Trust. It is represented that Trust was eligible to elect qualified subchapter S trust (QSST) treatment under § 1361(d). However, A, the sole beneficiary of Trust, inadvertently failed to make a timely QSST election under § 1361(d)(2). Therefore, X's S corporation election terminated on Date3.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and not motivated by tax avoidance. X and its shareholders

have agreed to make such adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

Law and Analysis

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides, in part, that the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for the purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E, part I, subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(1) provides that, in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), the trust is treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of the trust is treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) provides that the term “qualified subchapter S trust” means a trust, (A) the terms of which require that – (i) during the life of the current income beneficiary, there is only one income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust terminates on the earlier of the beneficiary’s death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust distributes all of its assets to that beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the trust must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as a S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the representations made and the information submitted, we conclude that X's S corporation election was terminated under § 1362(d)(2) on Date3 when X stock was transferred to Trust, because Trust failed to timely file the required QSST election under § 1361(d)(2). We further conclude that the termination was inadvertent within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date3 and thereafter, provided that X's S corporation election was otherwise valid and not otherwise terminated under § 1362(d), and provided that A files a QSST election for Trust with an effective date of Date3 with the appropriate service center within 60 days following the date of this letter. A copy of this letter should be attached to the QSST election.

From Date3 and thereafter, Trust will be treated as a QSST described in § 1361(d)(3) (assuming the trust otherwise qualifies as a QSST), and A will be treated as the owner of the X stock held by Trust. Accordingly, X's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately stated items of income (including tax-exempt income), loss, deduction, or credit and non-separately computed items of income or loss of X as provided in § 1366, make any adjustments to basis as provided

in § 1367, and take into account any distributions made by X as provided by § 1368. If X, or any of the shareholders, fail to treat X as described above, this ruling shall be void.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X is otherwise eligible to be treated as an S corporation or whether Trust is eligible to be a QSST under § 1361(d)(3).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

/s/

Tara P. Volungis
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes

cc: